unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service." (emphasis added). **[¶ 90]**

This unbounded "right to combine" is central to the Act's goal of permitting competitive entry on as flexible a basis as possible. It permits local competition to develop without the need to overbuild already adequate ILEC networks. It permits entrants who want to invest in new facilities to do so based on their own investment and market decisions rather than regulatory requirement. The right is absolute, and critical. The Act's legislative history also proves that Congress intended for carriers to be able to combine all unbundled elements in a platform configuration, and to pay cost-based rates for those elements. 34/ **[¶ 90]**

Section 251(d)(2)(B) also mandates the conclusion that Section 251(c)(3) permits carriers to combine all the unbundled elements. As discussed above, if new entrants that had no local facilities were constrained to resale of ILEC-created retail offerings, they would be unable to design innovative and competitive retail services for consumers. The ILEC's competitors must be able to compete across the same matrix of services that the ILEC itself offers, as well as to fashion new and competitive services that are responsive to customer needs. Thus, if an ILEC attempted to limit the combination of network elements, it would be

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34/ For more detail on the Act's legislative history, see Attachment A.

directly "impairing" the ability of the requesting carrier to provide a desired service. **[¶ 90]** 35/

C. SPECIFIC UNBUNDLING PROPOSALS

As discussed above, LDDS WorldCom agrees that the Commission should adopt a baseline set of unbundled network elements for purposes of this initial order. But that baseline is only a starting point for future unbundling requests that may be made of ILECs by other carriers. The Commission should make clear that its baseline regulations are not preclusive of additional disaggregation of the local network.

For purposes of the initial baseline elements, LDDS WorldCom endorses the list filed today by the TCC, including the definitions of the elements included in that filing. Specifically, we agree that the Commission should require, at a minimum, that ILECs immediately make available: the Network Interface

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35/ Some parties nevertheless have maintained that the plain language of Section 251(c)(3) can be read to deny the ability to purchase all network elements in combination. They suggest that the existence of the Section 251(c)(4) resale option in the Act somehow means that a telecommunications carrier must own at least one network element itself in order to qualify to purchase unbundled elements. This argument does nothing to address the plain language of Section 251(c)(3), which contains no such restriction, nor the legislative history behind it. It disregards the fact that most requesting carriers will interconnect with facilities they use for toll services. More fundamentally, however, this argument ignores the major differences between resale of retail services under Section 251(c)(4) and the purchasing of network elements under Section 251(c)(3). When those differences are examined, it is even more clear that Congress intended for telecommunications carriers to have both options. See Section IV. A.4., supra.

Device; Loop Distribution; Loop Concentrator/Multiplexer; Loop Feeder; Local Switching; Local Operator Services; Local Directory Assistance; Common Transport; Dedicated Transport; Digital Cross-Connect System; Data Switching Element; SS7 Message Transfer and Connection Control; Signaling Link Transport; SCPs/Databases; Tandem Switching; and Advanced Intelligent Network features.

We focus our specific comments here on the unbundled local switching element. This element has been the main issue that LDDS WorldCom has raised in state local competition proceedings over the past year. As discussed below, our particular concern is that local switching be provided in a manner that permits requesting carriers to combine it with loops and call termination to create a network facilities platform over which they can provision the local services they design and market. 36/

Such a combination of elements is crucial to LDDS WorldCom's ability to expand services to our nationwide customer base. We intend to combine the unbundled local switching element with other unbundled network elements to create a platform over which we can provide the full range of services that could be provided by the ILEC -- basic local exchange service, vertical services, interexchange services and exchange access. The principal elements of the network platform include the loop, switch capacity (including the ability to activate

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36/ See LDDS WorldCom Petition for a Total Wholesale Network Service Tariff, Illinois Commerce Commission Docket No. 95-0458.

functions in the local switch to provide optional services), and the seamless termination of "local" (i.e., non-subscribed) calls, with the routing of presubscribed traffic to a chosen network. The platform configuration thus represents the combined purchase of the basic individual network elements -- including loop, switch capacity and local termination -- necessary to provide local exchange and exchange access service. 37/

1. The Act Requires ILECs To Provide An Unbundled Local Switching Element.

[Notice, Section II.c(3)(b), ¶¶ 85, 90, 93, 98-103, 153]

In the Notice the FCC has proposed that unbundled local switching capability be provided pursuant to Section 251(c)(3). 38/ We strongly support this proposal. The FCC correctly pointed out unbundling of local switching is "critical to the implementation of section 251(c)(3) and the provision of competing telecommunications services." 39/ The FCC also correctly noted that the Section 271(c) "competitive checklist also specifies the unbundling of local switching from

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37/ The Illinois Commission was the first state to be asked to mandate an unbundled local switching element and a few other states have begun to examine it as well. Passage of the 1996 Act will require every other state to focus on this mandatory unbundled element.

38/ Notice at ¶ 98.

39/ Id. at ¶¶ 98, 100.

transport, local loop transmission, or other services as a precondition to BOC provision of in-region interLATA services." 40/

2. Definition of Unbundled Switching Element.

The proposal for a "local switching platform" being examined in Illinois, and described by the Commission in the Notice, 41/ provides a good model for an unbundled local switching element that should be mandated for all ILECs. 42/ The staff of the Illinois Commerce Commission has defined the network platform switching element as comprising:

> . . . all service and functionalities that are provided by a switch or end office. These services include: telephone number and directory listing; dial tone; announcements; access to operators, usage and interexchange carriers; originating and terminating switching; custom calling features (call forwarding, call waiting, etc.); and CLASS features (caller ID, call return, etc.) 43/

Unbundled local switching is equivalent to the lease of virtual switching capability (or, in the words of the Illinois staff, "virtual switch

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40/ Id. at ¶ 98.

41/ Id. at ¶ 100.

42/ That platform concept, which has been supported by the Illinois staff and other parties in the Illinois proceeding, "is described in terms of 'virtual' switch capacity, including all the services and functions performed by the switch on a per line basis, such as dialtone, telephone number provision, all CLASS and CCF features, originating and terminating usage, and 911 service." Id.

43/ Testimony of Jake E. Jennings, ICC Staff Exhibit 1.01, Illinois Commerce Commission Docket No. 95-0458 (Filed December 21, 1995) at 7.

capacity"). 44/ This capability would include the ability to connect lines, provide features, collect information necessary for billing, and designate the trunk groups to which interoffice transport should be directed. It also would include the capability to activate all of the switch features and functions that would enable a new entrant to design its own services, with its own particular competitive features, rather than being forced to mirror the ILEC's own end user offerings through service resale under Section 251(c)(4). A requesting carrier must have the ability to offer different services than the ILEC by activating other features in the ILEC switch. Competitively designed services would be encouraged even further with unbundled access to Advanced Intelligent Network (AIN) triggers. 45/

Unbundled local switching also should enable competing carriers to recognize customer requests for service, obtain required call specific information, perform data analysis, select traffic routes, perform call signaling, complete or hand-off calls, record for billing and network management, and handle testing required for network maintenance and call processing. There should be no limitations on the capabilities that carriers can access in the ILEC switch. If an ILEC uses a capability, then that capability must be available to its competitors -- as well as any other capability that it is technically feasible for the ILEC switch to

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44/ Id. at ¶ 100. See Testimony of Jake Jennings, ICC Staff exhibit, supra.

45/ See Notice at ¶¶ 113-114.

provide. Without this, competitors will never be able to match or beat the ILEC offerings and innovation will be stifled. **[¶ 102]**

In sum, the Commission should require ILECs to offer an unbundled local switching element that can be combined with other ILEC network elements as a platform over which competitors can provide the full range of services provided by ILECs, including exchange access. The Commission should specify that the unbundled element should provide purchasers access to every capability and functionality of the local switch. The Commission should begin with the Illinois staff definition as a model, and expand on it based on the views of the parties that are interested in purchasing unbundled switching and their particular requirements.

Finally, any such definition must include the operational support necessary: (1) to make service provided over unbundled elements of the same quality as that provided by ILECs to their own customers; (2) to make switching local service providers as easy as switching long distance companies; and (3) to include provision of data necessary to enable purchasers to bill other end users for services and interexchange carriers for access. **[¶¶ 98-103]**

Limitations of Unbundled Loops.

The importance of unbundled local switching becomes even more clear when one appreciates the inherent limitations of unbundled loops alone. Although it is possible to provide competing local service by installing a local switch and

purchasing unbundled loops from the incumbent ILEC, the practical and economic limitations of this entry model make it viable only for a small segment of customers -- chiefly business customers that are located near dense central offices. The Commission recognized this reality in the Notice, where it cited AT&T estimates that AT&T "would have to invest approximately $29 billion to construct new facilities in local markets in order to provide full facilities to reach 20 percent of the 117 million access lines serviced by the BOCs," a figure representing about 6 times AT&T's total capital construction cost for 1995. Notice at ¶ 7 and n.15.

There are several limitations to reliance upon unbundled ILEC loops alone as the sole or primary means to provide competing local service. First, the unbundled loop configuration is viable only where a collocated interoffice network exists that duplicates the ILEC interoffice network. Requiring competitors to replicate the ILEC transport network as a predicate to offering local exchange service throughout a region is only slightly less a barrier to entry than extending buildout of alternative networks to each and every subscriber premise.

Second, the unbundled loop configuration is not supported by the administrative and operational systems necessary to effect the transition to full service competition. The unbundled loop configuration requires a physical change in the network -- i.e., the actual loop to the customer must be reconfigured from the ILEC's switch to cross-connect to a competitor. Physical circuit reconfigurations are

far more difficult than the software-controlled process currently used to effect a change in a customer's long distance carrier (the PIC-change process).

The limited capability of loop unbundling is demonstrated by the ILECs' own admissions. For example, in Pennsylvania, Bell Atlantic's witness testified recently that Bell Atlantic can provision only 25 unbundled loops per week, per LATA, per co-carrier during a three-month "ramp up" period. 46/ Bell Atlantic does not know, moreover, whether it will it will be able to provide unbundled loops at a significantly faster rate after that ramp up period is over. 47/ The transcript is telling:

> Q: Can you tell us, given your understanding of Bell Atlantic's design capacities and this process of providing unbundled loops, how many loops per week or month you expect competing carriers to be able to buy after this three-month [ramp up] period is over?
>
> A: I don't think I can.
>
> Q: Dozens, hundreds?
>
> A: I don't know what kinds of demands they'll hit us with, and basically we've never done this in large quantities yet.
>
> Q: So you're claiming that you have no knowledge regarding the design capacity of providing unbundled network loop elements?

46/ Bell Atlantic Statement No. 2.1 (Rebuttal Testimony of Albert) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 14.

47/ Tr. at 956-61 (Bell Atlantic Witness Albert) (April 12, 1996) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al.

A: No. In terms of capacity, the physical plant is out there, we have capacity to provide the unbundled loops. The difficulty is just operationally.

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Q: So, because you say you're the expert, no one at Bell Atlantic has done any estimates of how many loops they could provision out?

A: No, and I haven't been asked. 48/

In stark comparison, there were an estimated 30 million long distance PIC changes made in 1995. 49/ It should be apparent that the unbundled loop model for entry alone will not be adequate to permit mass entry into the local market.

The record is clear, moreover, that the process used to switch customers to new local providers is relatively untested and will be more cumbersome and expensive than the automated PIC-change process used to switch customers to new long distance providers. Indeed, in its unbundling proposal, Bell Atlantic estimates that "the 'cost-based' charge to shift a customer to a new local

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48/ Tr. at 957-959 (Bell Atlantic Witness Albert) (April 10, 1996) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al.; see also Comments of the Telecommunications Division (TE-1363), Maryland Public Service Commission, Bell Atlantic-Maryland, Inc. Mail Log Nos., 51043 et al., March 27, 1996, at 4 (recommending that Commission reject 25-loop limit because "BA-MD has not explained the critical elements that would justify such a limitation for all central offices").

49/ See Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier, Order, FCC 95-427, rel. October 23, 1995 ("Non-Dominance Order"), at ¶ 63. This figure corresponds to "churn" rates of up to 20 percent for residential customers. Id.

provider using an unbundled loop is $122 per loop" whereas "Bell Atlantic's charge to process a PIC-change request is only $5 per line." 50/ This is unacceptable because entry to the local market should be just as easy and inexpensive as entry into the long distance market.

Third, the unbundled loop configuration demands extensive investment in local switching and interoffice facilities -- investment that will require considerable time to accomplish even where it is cost-effective, therefore delaying competitive benefits for consumers in many areas.

Finally, loop unbundling is fundamentally not a practical near-term strategy for a long distance company like WorldCom with a widely-dispersed customer base. Loop unbundling may work for a new company that is just beginning to sign up retail customers. Such a company can put a telephone switch in a downtown city center, and then try to win customers located near that switch away from the ILEC. It can expand gradually as success in the first city areas permits investment in others. It need not serve customers in suburbs, smaller cities and rural areas for years to come (if ever), at least until traffic volumes justify additional facilities investment. But that gradual expansion business case is not relevant to a long distance company that must prepare to defend its existing customer base from the RBOCs everywhere. Nor is it relevant to the tens of

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50/ CompTel Statement No. 1.0 (Direct Testimony of Gillan) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 21.

millions of consumers who happen not to reside in an area served by an ILEC competitor employing unbundled local loops.

The point here is not that loop unbundling is unimportant -- on the contrary, it will be a useful entry mechanism for some carriers serving some customers. But loop unbundling alone will not work for carriers that need to serve an existing base of geographically dispersed customers. Nor would it give consumers competitive choices anytime soon.

In the Notice, the FCC recognized that Congress provided options for entrants, declining to make ownership of local exchange facilities a prerequisite to participation in the provision of competing local exchange service:

> Different entrants may be expected to pursue different strategies that reflect their competitive advantages in the markets they seek to target. For example, interexchange carriers and competitive access providers may combine their own facilities with unbundled loops and other LEC elements and perhaps augment their own loop facilities over time. Cable systems may choose to develop more extensive networks within their service areas, and thus require fewer unbundled elements from LECs; but, like all entrants, they will require termination arrangements with incumbent LECs. Outside their franchise areas, or in areas not passed by their existing systems, cable companies will need to find some other technique for offering telecommunications services, such as resale of incumbent LEC services or purchase of unbundled LEC elements. 51/

The FCC also recognized that:

51/ Notice at ¶ 9 (footnotes omitted).

> the likely effect of the unbundling and other provisions of the 1996 Act is not to ensure that entry shall take place irrespective of costs, but to remove both the statutory and regulatory barriers and economic impediments that inefficiently retard entry, and to allow entry to take place *where it can occur efficiently*. 52/

In light of these goals, then, the Commission must ensure that new entrants have access to switch capacity and switch features and functions, as well as loops and other unbundled elements, so that these entrants may bring competitive choices to all consumers without first being required to make uneconomic investments in local exchange facilities.

Inadequacy of Unbundled Ports.

The Commission asks for comment on whether other formulations -- such as unbundled ports -- would satisfy the Act's unbundling requirements. While we have no objection to unbundling the switch port, the port clearly does not constitute unbundling of switching capability. MCI's definition of a port, for example, as "the link from the ILEC main distribution frame to the switch" makes it clear that the switching functionality is not part of the port.

As defined in other states, an unbundled port clearly does not constitute unbundled switching. In New York, for example, the Public Service Commission has unbundled the link and the port, but without significant focus on the role of the port. As the FCC recognized, the port under that definition is

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52/ Notice at ¶ 12 (emphasis added).

"essentially an interconnection point into the rest of the NYNEX network" and is not "an unbundled network element that a competing carrier could combine with its own transport and other loop facilities to provide a competing telecommunications service." Notice at ¶ 101. The New York Commission definition of port does not offer users access to switching functionality. **[¶ 101]**

Bell Atlantic has defined an unbundled port in Pennsylvania proceedings as something that "provides the ability to originate and terminate local and toll calls, but does not include usage or access charges associated with those functions." 53/ An unbundled port, under Bell Atlantic's definition, "can be used in conjunction with, but does not include, vertical features available in or through Bell's switch." 54/ Under this definition of an unbundled port, competing carriers must purchase, in addition to an unbundled port, Bell's retail local exchange service ("usage") and exchange access as well as vertical features in order to provide competing local exchange service. 55/

53/ Proposal of Bell Atlantic - Pennsylvania, Inc. for Phase II of Local Competition Proceeding, In re Application of MFS Intelenet of Pennsylvania, Inc. et al., Docket Nos. A-310203F0002 et al., December 1, 1995, at 16. (hereafter "Bell Atlantic December 1, 1995, Proposal"). See also BA Statement No. 2.0 (Direct Testimony of Albert) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 12-13.

54/ Bell Atlantic December 1, 1995, Proposal at 16.

55/ "Bell proposes to charge for usage and switched access in addition to the basic rate for the unbundled port facility itself. The charges should be the tariffed rates, less the portion of the tariffed rates that would be avoided." BA Statement No. 1.0 (Direct Testimony of West) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 18.

Thus, this definition of a port also fails to satisfy the Act's Section 251(c)(3) requirement for unbundling of network elements. First, it fails to include local switching capability. Second, it requires carriers to purchase ILEC retail and access services in addition to unbundled elements. 56/ In addition, this definition fails to satisfy the network unbundling requirement because it denies purchasing carriers the ability to provide the full range of services that the ILEC would provide over those facilities, including exchange access. **[¶ 101]**

These formulations of an unbundled port also fails to satisfy Section 271(c) of the Act. Section 271 specifies the minimum unbundling that must occur before an RBOC may provide interLATA services. These minimum requirements, inter alia, include the provision of:

> (iv) Local loop transmission from the central office to the customer's premises, unbundled from local switching and other services.
>
> (v) Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching and other services.

56/ Joint Comments at 10; see also CompTel Statement No. 1.0 (Direct Testimony of Gillan) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 8-9; AT&T Statement No. 2.1 (Rebuttal Testimony of Riggert) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 4-5. As noted in the Joint Explanatory Statement accompanying the 1996 Act, "the term 'network element' was included to describe the facilities, such as local loops, equipment, switching, and the features, functions, and capabilities that a local exchange carrier must provide. . ." Joint Explanatory Statement of the Committee of Conference to accompany Telecommunications Act of 1996, at 116 (emphasis added).

(vi) Local switching unbundled from transport, local loop transmission, or other services. 57/

For a switching element to be considered unbundled, the purchasing carrier must have the ability to combine it with loop and trunking facilities chosen by the purchasing carrier, and the ability to configure the services that will be offered using that switch. This is a central purpose of the network unbundling requirement of the Act. An unbundled port, which forces competing carriers to purchase additional usage and access services from the ILEC, fails to satisfy these requirements because it is not physically separated from other elements and because it is not offered independently of the ILEC's other services. 58/

The point here is that although the concept of unbundled switching is still under development at the state commission level, the FCC must establish a baseline requirement for that critical network element.

3. Administrative Issues Related to Switch Unbundling

Technical Feasibility.

The FCC correctly reached the tentative conclusion that if an ILEC has been able to interconnect with other networks or facilities at a particular point, that point is a "technically feasible" point of interconnection within the meaning of Section 251(c)(2)(B). Notice at ¶ 57. The FCC should also take a similar approach

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57/ 47 U.S.C. § 271(c)(2)(B) (1996).

58/ See CompTel Statement No. 1.0 (Direct Testimony of Gillan) in Application of MFS Intelenet of Pennsylvania et al., Docket Nos. A-310203F0002 et al., at 6.

in evaluating claims of technical feasibility in relationship to switch unbundling. Thus, if an ILEC currently provides service via a particular capability in its switch, that capability should by definition be included within the meaning of unbundled switching element.

Operational Support.

As with unbundled network elements generally, the availability of automated, nondiscriminatory operational support mechanisms will be critical to the practical availability of unbundled switching. The Commission should require that such mechanisms be in place and proven workable before concluding that the Section 251(c)(3) requirements have been satisfied. **[¶¶ 89, 91, 98-103].**

In particular, carriers purchasing unbundled switching must have access to the Carrier Access Billing System ("CABS") billing data that they will require in order to bill their interexchange carrier customers for access. If necessary, CABS billing systems must be modified to provide for this data. The data must be available either as a separate unbundled element or as a part of the provision of unbundled switching. **[¶¶ 89, 91, 116, 98-103].**

Rate Structure for Unbundled Switching.

Unbundled switching, like other unbundled network elements, must be priced in accordance with Section 252(d)(1). As we discuss in detail in Section V below, Section 252(d)(1) requires pricing at economic cost or TSLRIC.

The Commission also has asked for comment on the pricing of shared facilities, including incumbent ILEC switching. Switching costs are a function of line connection, trunk connections, and busy hour demand. The price of the unbundled switching element should reflect as closely as possible the manner in which switching costs are incurred. Line-related costs should be recovered through a flat per-line capacity charge, based on a contracted-for number of lines (or switch capacity). Trunk-related costs should be recovered through a minute-of-use charge, reflecting the fact that each trunk-port is a common resource. 59/ Busy-hour related costs should be recovered through a combination of per-line and usage-based charges. This structure should reflect the relative use of the switch for line-to-trunk connections (which could be usage-based charges) versus line-to-line connections (which should be flat charges). Over time, this basic approach may require modification to account for differences between busy hour demand patterns for carriers purchasing unbundled switching and those patterns for incumbent ILECs. **[¶¶ 100, 153]**

There should be no additional charges for vertical features provided by the switch (CLASS or custom calling features), as the cost of providing those features is already reflected in the charge for the contracted switch capacity. Little if any incremental costs are associated with these features.

59/ These costs may be sufficiently small so as not to warrant a separate usage - based charge.

V. THE ACT REQUIRES PRICING OF INTERCONNECTION AND UNBUNDLED NETWORK ELEMENTS AT ECONOMIC COST (TSLRIC)

[Notice, Section II.B.2.d.]

A. The FCC and the State Commissions Have Critical Roles in Pricing.

[Notice, Section II.B.2.d.1, ¶¶ 117-120]

As in other areas, LDDS WorldCom strongly urges the FCC to set a national standard for pricing of interconnection and unbundled network elements under Section 252(d)(1). We discuss below why that standard must be economic cost or TSLRIC. States also have a critical role in this endeavor, because they must order and review the cost data and set the rates themselves for interconnection (including interexchange access) and for unbundled network elements. Moreover, once interexchange access is reformed and brought to cost -- along with other forms of interconnection -- it will be the state commissions, subject to federal guidelines, that will set the rates for interconnection for all services. 60/ **[¶¶ 117-120]**

We discussed in Section II above why uniform national standards, with a strong implementing role for the states, are critical to the success of

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60/ As discussed below in the section on interconnection, we urge the FCC to interpret Section 251(c)(2) as encompassing interexchange access as interconnection. We also point out that once a transition period is completed, interstate access rates will be set by state commissions, because interstate access, intrastate access, and local call termination will all be priced the same -- because all are interconnection. **[¶ 120]**

competition. We also stress that in regard to pricing, as with all the competitive protections of the Act, it is critical that the FCC use the "carrot" of interLATA entry to ensure that the Act's provisions are correctly and fully implemented by the RBOCs for they have no incentive to do so otherwise. **[¶¶ 117-120]**

In these comments, LDDS WorldCom will emphasize the importance of economic cost as the basis for setting network input prices. We also endorse the joint filing of the Telecommunications Carriers for Competition (TCC), which addresses cost and pricing issues in greater detail than we do here. 61/

B. Section 252(d)(1) Mandates Economic-Cost Pricing

[Notice, Section II.B.2.d.2., II.B.2.d.3.a., ¶¶ 121-133]

Section 252(d)(1) of the Act requires interconnection and unbundled elements to be priced on the basis of cost, without reference to traditional rate of return pricing principles. That Section also requires the Commission to determine "just and reasonable" prices for interconnection and unbundled network elements "based on cost . . . of providing the network element," and requires such prices to be nondiscriminatory. See 47 U.S.C. § 252(d)(1)(A). Section 251(d)(1)(A) also requires state commission determinations of the rates for interconnection and for unbundled network elements to be "based on the cost (determined without reference to a rate-

61/ That filing elaborates on TSLRIC pricing, and discusses a cost model based on recent analysis of Hatfield Associates.

of-return or other rate-based proceeding) of providing the interconnection or network element . . ." 47 U.S.C. § 252(d)(1)(A) (1996).

As the FCC tentatively concludes, the plain language of Section 252(d)(1)(A) therefore requires that rates for unbundled network elements be priced at direct economic cost (or TSLRIC), as opposed to traditional, fully distributed rate-of-return pricing. 62/ This is so because there are two basic approaches to defining costs: (1) cost determined by fully-distributed, rate-base accounting, and (2) economic cost, reflecting the direct resource cost of providing a service or network element. The Act's explicit rejection of the former standard is a strong indication of its preference for the latter. Congress must have meant, in defining cost in this manner, that the incumbent local exchange carriers not be entitled to charge other carriers (their direct competitors) rates that reflect all the elements that go into a traditional rate-of-return or rate base proceeding. **[¶ 123]**

There is no place for embedded or historical costs in rates for unbundled network elements or interconnection. Any universal service concerns raised by pricing at economic cost can and should be addressed in the Commission's universal service docket. As discussed below, we propose a transition plan that would enable the FCC to complete that proceeding before completion of the task of bringing interexchange access to economic cost. **[¶¶ 144, 145, 146]**

62/ Notice at ¶ 123.

We disagree, however, that the Act would permit regulators to use price cap regulation to set rates for interconnection and unbundled network elements. Most rates that were set on the basis of a price cap system were capped at rates that were established under traditional rate-of-return methodology. This certainly was the case with regard to the FCC's own price cap scheme. 63/ Then, to the extent the rates have departed from the initial rates, they have done so without relationship to changes in costs. Thus, rates established under a price cap scheme cannot form the basis for rates that are set "on the basis of cost" as required by Section 252(D)(1)(A).

The provision in the federal statute that permits inclusion of a "reasonable profit," 47 U.S.C. § 252(d)(1)(b)(1996), moreover, is entirely consistent with economic-cost-based pricing. The economic cost calculation (or TSLRIC) already includes a reasonable profit. "Reasonable profit" cannot be read to include "contribution" to costs that have nothing to do with providing the network elements or interconnection that are the subject of the Section 252 pricing standard. It therefore cannot be read to permit allocation of common costs and overheads to network prices.

Pricing of interconnection and unbundled network components should be at the ILEC's economic cost for competitive policy reasons as well as for statutory

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63/ Even then, the rates were never categorically determined to be just and reasonable. Rather, the FCC concluded that the existing rates could form a reasonable basis for beginning a price cap system.

reasons. Only by facing the same cost structure as the ILECs will new entrants be in a position to offer competitive services over ILEC network facilities. Economic cost -- or TSLRIC -- is generally viewed as a correct measure of the cost structure facing the incumbent LEC itself, the cost structure that guides it in making competitive pricing decisions. As the Commission correctly observed,"[e]conomists generally agree that rates based on LRIC give appropriate signals to producers and consumers and ensure efficient entry and utilization of the telecommunications infrastructure." Notice at ¶ 124.

TSLRIC is a commonly used cost standard in state commission rate proceedings, with the ILECs themselves frequently relying upon TSLRIC to calculate their input costs for providing a particular service. Once having established that TSLRIC is a correct measure of the cost to the LEC of providing a service, LECs have argued that any price covering that cost is inherently justified. Thus, economic cost has commonly been used to justify price floors for services for which the ILECs face competitive threats -- because economic cost is covered, the ILEC's costs are covered, and the price is by definition not considered anticompetitive.

This point is a critical one. This proceeding is all about establishing the ground rules upon which potential ILEC competitors will be permitted to use the ILEC network to compete against the ILEC in the same retail markets. The premise of the statute is that the incumbent LECs are in possession of a unique

resource -- the ubiquitous local wireline exchange network -- and that any carrier that wishes to compete directly with the ILEC will require access to the ILEC network to do so. Thus, the Act establishes a pricing standard for use of the ILEC network that would put other carriers in a position to compete head-to-head, even if they do not have a duplicate local exchange network of their own. Moreover, this head-to-head competition will take place not only in the local market -- it will also take place in the long distance market. In both markets the incumbent LEC controls the essential input for others to provide service.

For the paradigm established by the Act to work, therefore, the LECs' competitors must pay the same effective price for using the LEC network that the LEC pays itself. This price is economic cost, or TSLRIC.

In the following testimony, a witness for BellSouth agrees that BellSouth's input cost for access is far above its own, incremental cost of access:

> [I]n the toll-access market, suppose the TSP [telecommunications service provider] entrant and the ILEC [incumbent LEC] are equally efficient in their use of non-access inputs, i.e., have the same LRIC for those inputs. Now, add to the TSP's cost the price it pays for purchasing access from the ILEC. Correspondingly, to its non-access costs, the ILEC must then also add the LRIC of "providing access" to itself. Despite starting out being equally efficient in their use of non-access inputs, at this point the ILEC would seem to have an unfair advantage over the TSP because it only pays itself the LRIC of access while the TSP must pay the price of access. 64/

64/ See Comments of BellSouth Telecommunications, Inc., in Development of Rules and Regulations Applicable to the Entry and Operations of, and the Providing of Services By, Competitive and Alternate Access Providers in the Local,

The point of this discussion is that the input cost facing the incumbent LEC is the economic cost of access. To put the LECs' competitors on an equal footing, the input price for competitors must also be economic cost. 65/

C. TSLRIC Studies Can Be Done Quickly To Establish Initial Rates for Interconnection and Unbundled Network Elements.

Notice, Section II.B.2.d.3.a.

The experience of state commissions demonstrates that TSLRIC studies can be prepared quickly and used to establish going-in interconnection and unbundled network element rates. Disaggregation of cost data on the basis of geographic differences is permissible, but only if the universal service fund has

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Intrastate and/or Interexchange Telecommunications Market in Louisiana, Docket No. U-20883, Testimony of Dr. William E. Taylor at 48, para. 99 (emphasis added).

65/ Imputation requirements alone do not solve the problem. That is so because the LEC still keeps the excess above economic cost that it is recovering in its above-cost retail rates. Structural separation requirements, even in conjunction with imputation requirements, also do not solve the problem, because the company as a whole still retains the excess earnings. It does not matter that one of the company's subsidiaries is losing money on paper.

Imputation also is not a realistic solution in a world of full-service packages. If the incumbent LEC is permitted to sell local service, wireless service, and perhaps other services in packages with long distance service, then requirements that long distance rates reflect imputed access charges are meaningless, because the LEC can simply reduce other prices in the package to avoid the real effect of any imputation requirement. The Commission can avoid enmeshing itself in the pricing of retail service packages and in issues regarding the earnings of separate subsidiaries only by pricing LEC inputs at economic cost. If the FCC does not require economic cost prices for inputs, including interexchange access, it will be forced to police LEC retail pricing and other behavior to ensure that the discrimination in input pricing does not totally distort competition. **[¶ 165]**